Understanding the "Procurement Business Case"

Striking a Balance Between "Following the Rules" and "Thinking Through the Nature of the Deal"

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A crucial benefit of the decade of acquisition reform is giving the government more leeway to structure business arrangements with industry in ways that increase the probability that contractors will deliver successful results to government customers. Within these arrangements, or relationships, the government and the contractor generally share a common set of top-level goals. These goals include the achievement of customer satisfaction, program stability, and positive program and financial performance.

Understanding the Business Case

Participants in successful business relationships develop a shared ability to find mutually beneficial solutions to achieve these goals. This requires a strategy that not only focuses upon the areas of performance interest, but also requires real understanding of the business case. For the government, this will likely include reduced total operating costs and performance that meets or exceeds stated performance requirements. For the contractor, it includes a stable program, the generation of positive cash flow and profit, and a satisfied government customer. Contractual strategies not based on a sound understanding of the business case risk incentivizing the wrong behavior and jeopardizing successful delivery of the requirement.

The contracting and acquisition workforce must focus not only on document execution, but also be meaningfully involved in the "front end" of an acquisition – the structuring of the "best deal." To do this successfully, the importance of understanding the business case surrounding the procurement cannot be overemphasized. New approaches are necessary to connect the contracting and acquisition workforce with the information and tools they need. One new approach to consider is *Factor Collaboration*℠ – the joint assessment of the influences and factors that impact the structure of a potential business relationship.

Through the disclosure and sharing of information essential to the planning and execution of a successful business relationship, *Factor Collaboration*℠ can increase the likelihood that contractors will deliver successful results to government customers. With the acquisition regulations and guidance as the framework, this can be a useful and structured process to assist government and industry jointly in achieving a more comprehensive understanding of the overall procurement business case.

Changing the Mindset – Changing the Culture

The concept of understanding the "procurement business case" as an initial building block of a successful relationship should be embedded within the contracting and acquisition workforce processes. The goal in contracting is not only to issue solid contracts, but also to support the development and execution of an effective business relationship that successfully delivers a product or service.

Defining, Incentivizing, Leveraging

Changing the mindset regarding the definition of a product, service, or deliver-

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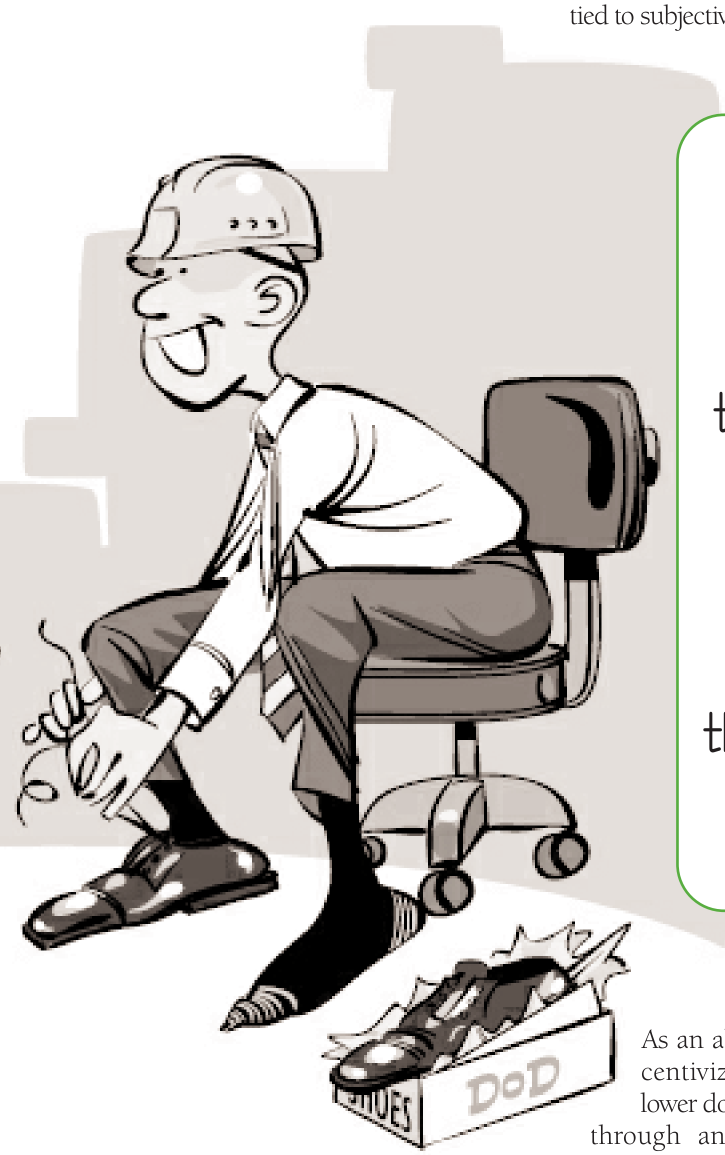
able begins by changing how the objectives are viewed in their entirety. What is really wanted? The goals of the program can define a "something" or they can define an "output."



For example, consider a services contract where the requirement is for copy services. The deliverable might be expressed as providing x number of copy machines. A better way to express the requirement might be as *x number of copies.* The requirement focuses on the output (the "what") and not the tool by which output is delivered (the "how"). The output is the responsibility of the contractor.

In another example, consider a supply and sustainment contract for an operational system. In many instances, a contract of this type might provide incentives for contractor performance through an award fee. In this example, assume that the contractor's performance meets requirements. Traditionally, award fees in this area might be relatively small and tied to subjective measures, not strongly enough to results; and may not include specific disincentives for poor performance.

The point is this: determining the best approach requires a change in the mutual thinking and understanding of the procurement business case and then effectively applying this knowledge and insight through planned application of an effective incentive strategy.

As an alternative, consider incentivizing the contractor to lower downstream support costs through an early investment in process improvements directed toward improved maintainability of parts and systems. Rather than specifying the specific parts needed, provide metrics that measure successful completion of the requirements for sustainment (e.g., operational readiness rates). If successful, the incentive might be additional periods of performance. If unsuccessful, the penalty might be a reduction in the period of performance.

The fee may not be the most effective incentive for this procurement and this contractor. The motivation of the contractor may not necessarily be instant profit or immediate cash flow, but a long-term relationship in which costs can be stabilized along with the contractor's workforce.

On a larger scope, consider the change in the industry perspective on research and development (R&D). The DoD share of R&D spending is shrinking, and fewer companies are willing to deal with the red tape associated with competing for those shrinking dollars. In fact, the strong economy has created a wave of technology development and gadgetry, and driven companies that might otherwise be interested in military work to more marketable endeavors where there is no question about who can profit from new innovations. The ability of DoD to leverage the commercial industry in the development and integration of new technology into weapon systems that must meet ever-changing threats is absolutely critical. At the same time, incentivizing industry to do business with the DoD when there are other lucrative markets with less stringent "rules of engagement" is becoming more and more challenging. What is the best way to capture this technology and innovation, and how best can DoD achieve this goal?

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Improving Communication

A path to better understanding is better communication and the formation of partnerships. In different areas of industry and government, however, many contractors and agencies still do not see themselves as "true partners." This historical relationship between government and industry is a limiting factor in developing new approaches to acquisition problems and common solutions that benefit both parties.

Both government and industry must concentrate on gaining insight into each other's motivation on a given procurement, through an open dialogue that seeks to align the goals of both parties to the maximum extent possible. Building trust is essential to creating and sustaining a successful business relationship.

Improving Leadership

Leadership that is committed to and understands change is necessary at all levels to ensure that "new" or "different" approaches become embedded in the culture. For example, the contracting workforce has not entirely made the transition to thinking of themselves as "business advisors and managers," with a key role in thinking through and proposing solid incentive strategies.

Leadership within all levels of the contracting community is needed to guide and support this role transition. The contracting workforce must be involved in early and meaningful planning that supports the development of the business strategy. If engaged at a later point in the acquisition, the contracting workforce will only be exposed to part of the planning process, with a less-than-ideal-business relationship the result.

Improving Training

Training reinforces the business process that the workforce uses in developing its approach to business relationships with industry. To change the approach, the government must change its culture and training.

The contracting workforce must expand their thinking and understand issues across the acquisition disciplines, moving away from the narrow perspective they have of contracting derived from a culture embedded by training. Training in the schoolhouse and on the job must change the focus of the workforce from "following the rules," to include "thinking through the nature of the deal" and ensuring that both parties' goals are satisfied.

Rewarding Innovation Will Drive Cultural Change

A likely consequence may be some failures; these must be accepted if innovation is to succeed. Innovators should be rewarded, *even if they fail*. Rewarding innovation continually incentivizes the progress that innovation can bring. This support to the workforce is needed and required to overcome the natural fear of failure and the consequent reluctance to be innovative. The workforce should be convinced that no punishment will be meted out for carefully considered risk-taking. In fact, it should be demonstrated that the "no-penalty, safe-business-as-usual approach" is fast becoming outdated.

Incentives can be provided as a reward for innovation. A number of different ways now exist to reward those innovators within the government who dare to take risks. As a minimum, these include incentives such as office gain sharing, individual gain sharing, and highlighting contributions in lessons-learned activities. It will take leadership at all levels, and possibly regulatory change, to expand the avenues for rewarding innovation (including monetarily) in new and effective ways.

Improved communication, improved training, and improved leadership are essential to "reinvesting" the lessons learned within schoolhouses and throughout the workforce. The transfer of knowledge and experience to all levels offers an exceptional opportunity to provide a continuum of innovation that can build upon itself. This can only happen if innovation and creativity are encouraged, recognized, and rewarded at all levels of the acquisition and contracting community.

The *Factor Collaboration*SM Process

Business relationships must be structured in a way that maximizes the chance of a successful win-win partnership. Not only must the relationship deliver what is required to the government customer, but also it must appropriately balance risk between the government and the contractor. In addition, it must appropriately reward the contractor for assuming the performance risks. Contracts must not be structured to offer incentives for contractors to behave in ways counterproductive to the purpose of the contract.

Traditionally, the government team developed and implemented an acquisition strategy for a competitive or sole-source procurement that may or may not have included meaningful industry involvement. If it did not, consequently the team lacked real insight to the business case and the industry issues.

As acquisition reform gained effectiveness, earlier teaming of all parties interested in the success of procurement, including the contracting community, became a more common occurrence. Today, it stands as a hallmark of a successful procurement.

But early involvement alone is not sufficient for success. Rather, the process of early involvement creates a cooperative atmosphere that greatly influences the probability for success. A successful business relationship must include a clear understanding of the goals of the procurement and the motivations of all interested parties associated with the procurement.

*Factor Collaboration*SM Defined

As stated previously, *Factor Collaboration*SM is the joint assessment of influences and factors that impact the structure of a potential business relationship. It promotes and supports a "meeting of the minds" with respect to the procurement and its business case and "forces to the surface" critical information necessary for the construction of that successful business relationship in these important areas:

- Requirements
- Influences and Factors

- Motivation
- Most Effective Incentive

For the government, the factors are key decision points used in crafting the acquisition and contract strategy for the procurement. For the contractor, they go initially to the "bid decision" followed by price, performance commitments, and other terms and conditions they are willing to propose in entering into a business relationship with the government.

Unique knowledge may drive a differing assessment of a given factor. Surfacing and discussing these differences provides an opportunity to improve the understanding of the business case and to provide the insight necessary for understanding each other's motivation. This understanding can lead logically to considering which contractual incentives are needed by industry and can be offered by government to meet the goals and objectives of both parties.

Business Case Factors

The factors reflect a baseline for further development and constitute major considerations within the business case.

Requirement

What is needed and being purchased — systems, spares, base support, services, construction, commercial items, or information technology — and how it is specified or described.

Acquisition Phase

The major phase of the acquisition cycle — R&D, production, or sustainment.

Primary Performance Risk Parameters

Three main performance parameters targeted by contractual incentives: technical performance, cost, and schedule.

Size

Relative assessment as a "large" or "small" procurement. For industry, relativity is a function of internal or corporate definitions of size. For the government, it is defined by the Federal Acquisition Regulation (FAR).

Contract Type

While vehicles such as "other transactions" may be considered, the two major types of contract vehicles of interest here are *fixed price* or *cost reimbursement.*

Program Stability

This factor refers to a program's susceptibility to disruptions in funding, schedule, requirements, and political and other support. While the government and the contractor will view basic program stability more or less in the same light, the contractor may also view stability in additional ways, including:

- Ability to project forward with certainty.
- Stability to develop an efficient supply chain.
- Ability to recover front-loaded costs.

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Program/Contract Flexibility

This factor refers to the flexibility of the program and adaptable contract vehicles. This can be viewed in a variety of ways, such as:

- Ability of the contract structure to allow for terms and conditions to evolve with the program.
- Process for how this contract will/can evolve as a result of changes. (An example of this is the opportunity or ability to negotiate a strategic alliance or overarching partnership agreement that includes problem-solving rules. The program is viewed as a whole rather than as specific projects and contracts.)
- Mechanism for the contract change process.

Competitive Environment

The government, within the laws that require competition or a justification for its absence, evaluates the opportunities to compete the procurement and the effectiveness of competition in successfully fulfilling requirements. Examples include:

- Competition in general.
- Ability to structure incentives to maintain contractor efficiency throughout the period of performance.
- Assessing the option of introducing competition when a contractor is performing poorly.
- Incentivizing participation in circumstances where there is limited or no competition.

The contractor evaluates the chances of competing and winning. Issues can include the following:

- The chance of recovering the "costs of competition" and in some instances, the "nonrecurring costs of market entry."
- Opportunities for successive, related, or follow-on contracts.

Entry Barriers

The government evaluates the marketplace for the goods or required services, and assesses the conditions that might adversely affect the opportunities for contractors to successfully compete. With respect to incentives, the degree of incentivization applied may directly affect the number and type of offerors that consider the procurement opportunity.

The contractors assess the obstacles or challenges they face to become "players" in the procurement. The perceived importance and value of the incentives will determine participation. Examples include:

- Period of performance considerations—time to recoup investment in front-loaded costs.
- Relative competitive advantage with respect to costs of performance.
- Incentive considerations—sufficient incentive opportunity to be earned to justify an investment by the contractor.

Performance History

The government considers the past performance of the contractor(s) as an indicator of future performance. The contractor, in considering this factor, is interested not only in how this assessment will affect its win probability, but also how they are viewed within the industry or marketplace—their competition.

Future Effort

The opportunity for future contracts for follow-on work, related work to other programs, spares, and other support.

Corporate Strategy

While the government is concerned with a contractor's approach to the procurement, this area primarily involves the contractor. Areas of importance include the following:

- Impact of the procurement to return on investment (ROI).
- Impact to cash-flow timing.
- Impact on market share.
- Access or opportunity for access/improvement in technology.
- Timing considerations, such as "first to market" advantages.
- Supply chain considerations, including maintaining good relationships with suppliers and processes that lend themselves to an advantage for other contracts.

Inherent Risk

The government views this factor as an assessment of contractor capability to handle or mitigate the commonly understood areas of risk (cost, schedule, and performance) during the performance of the contract. There are two components: the probability of failure to achieve the desired goals and the consequences of that failure.

The contractor also views this factor within the context of business and market risk. This includes the opportunity costs of investment in this effort, compared to other investments and the costs associated with failure in the marketplace. Business risk also includes such areas as the potential for changes in business base, rates, and inflation during the terms of the contract.

Industry Dynamic

This factor addresses the maturity of the industry area that would be covered by the procurement. The government focus can include assessing the opportunity for participation and the necessity and structure of incentives to attract interest.

The contractor is interested in the opportunity for growth within its industry: Is it increasing (i.e., in a new and innovative technology area)? Has it leveled off? Or are opportunities declining?

The Concept

Through the disclosure and sharing of information essential to the planning and execution of a successful business relationship, *Factor Collaboration*SM can increase the likelihood that contractors will deliver successful results to government customers. It can effectively support both sole source and competitive procurements. The concept for its use is briefly reviewed in the discussion that follows.

Sole Source

As early as possible, both the government and the contractor review the factors they believe are relevant to the procurement. The government will generally have greater initial insight into the factors relevant to the requirement and procurement strategy, while the contractor will generally have greater initial insight into factors relevant to their internal decision making.

The government and the contractor must openly and honestly assess all of the factors because their unique perspectives define the most effective contractual incentives for the instant acquisition. In some cases, perspectives will overlap, while in other cases, perspectives will diverge given the factor considered and the level of insight and information available to each party.

Exploring these "differences in perspective" should surface critical information necessary for a more complete understanding of the business case. This process will help the parties collaboratively define an incentive approach that:

- Recognizes the needs and motivations of the parties at that particular point in time and through the period of performance.
- Reflects a contract strategy that the government believes will ensure delivery of the requirement successfully and at "greatest value."

Note that Concept Exploration is not included in this discussion.

Competitive

*Factor Collaboration*SM can also be useful within a competitive environment. Although certain information may not be available initially as in the sole source environment, given the recent changes to FAR Part 15 on communication between the government and the offerors, it may now be easier to conduct the analysis discussed earlier without affecting the integrity of the source selection process. Exchanges with potential offerors, prior to release of the request for proposal (RFP) and receipt of proposal, would be similar to the current process involving early involvement, such as industry forums, draft RFP exchanges, and so on. There needs to be latitude in Section L and Section M of the RFP for offerors to propose different or innovative incentives.

The "greatest value" concept is based on a broader perspective than best value. While "best value" takes into account a standard to meet (i.e., good, better, best), "greatest value" may recognize that the selection may not in fact be the best of all alternatives. It may, however, be good enough, and by paying less for the service or support, still meet the requirement at lower cost and risk.

After receipt of proposals, discussions based on the individual contractor's approach and perspective on the factors could include tailoring contractual incentives appropriate for that offeror and its potential relationship with the government. One example might be the prospective tailoring of incentives to improve performance of the potential offeror in an area identified as weak, but necessary for the success of the delivery, through evaluation of past contractor performance.

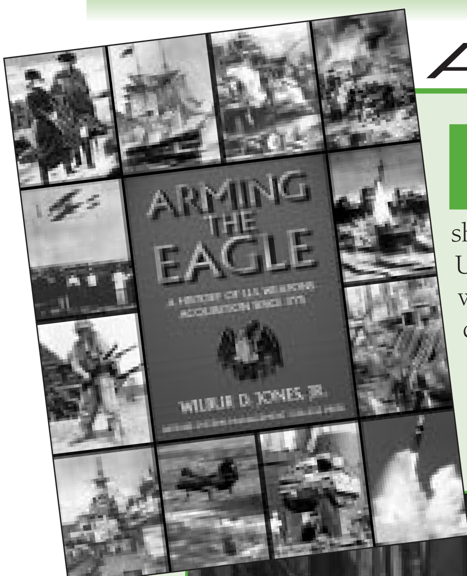
Individual contract arrangements might differ among contractors. The integrity of the source selection process, however, must be maintained. Discussions may not impart a unique advantage or provide insight to another's proposal or approach. The goal is to enable the offeror to provide the best possible proposal and for the government to improve the probability of the successful delivery of the requirement.

As part of the award, the terms and conditions of the successful offeror's contract could address tailoring the incentives through an "incentive adjustment plan" laid out in the successful offeror's proposal. During the subsequent period of performance, this post-award tailoring could address improvements to the incentives that were applied, based upon changes in the factors affecting the business relationship.

In summary, *Factor Collaboration*SM, as part of a comprehensive examination and understanding of the business case, can facilitate the gathering of critical information necessary to the construction of a successful business relationship.

Editor's Note: The author welcomes questions and comments about this article. Contact him at **WILLIAM.S.KAPLAN@saic.com.**

DSMC Publishes Long-Awaited History of U.S. Weapons Acquisition



ARMING THE EAGLE

Retired DSMC professor Wilbur D. Jones Jr., signs copies of his book, *Arming the Eagle: A History of U.S. Weapons Acquisition Since 1775*, during a recent visit to Scott Hall, DSMC main campus, Fort Belvoir, Va. *Arming the Eagle* is a series of essays, or snapshots, of various periods in the country's military history. The essays tell the story of how U.S. weapons were developed and produced, what notable managers and organizations were involved, and which weapons from those periods significantly impacted national conflicts. The book may be ordered from DSMC and the Government Printing Office. Call DSN 655-2151 or (703) 805-2151 for price and ordering information.

Pictured from left: DSMC contract employee Kevin Parr; Jones; Army Sgt. 1st Class Frances Battle.

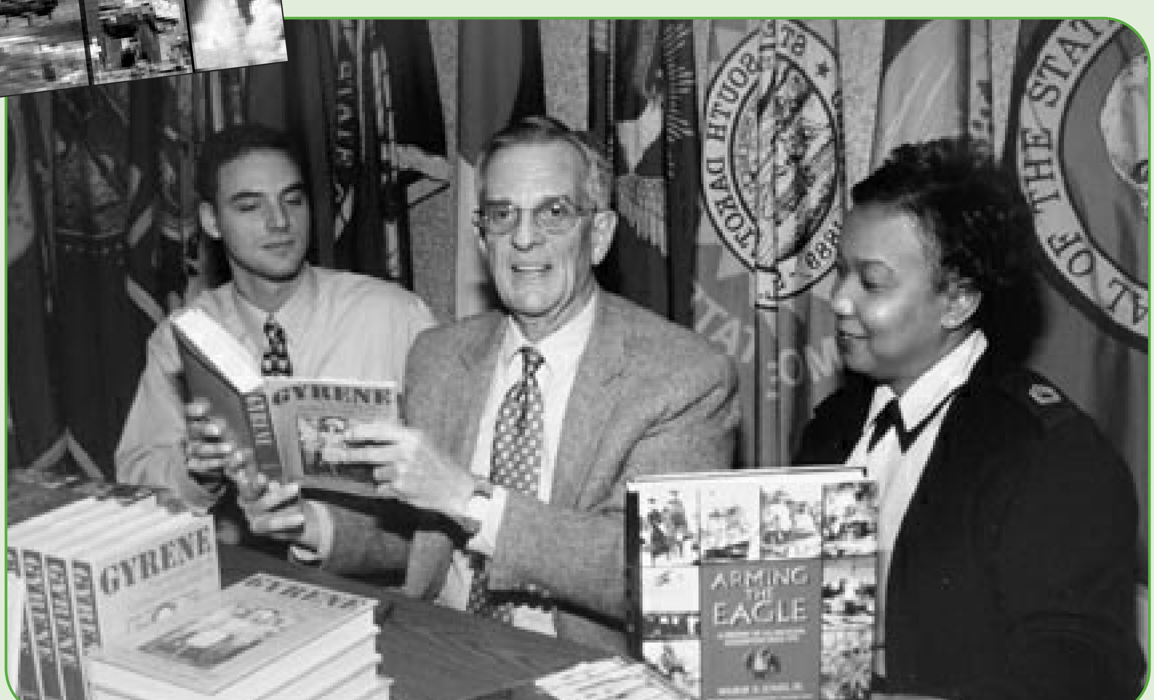


Photo by Richard Mattox